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Nos. 13-1421 and 14-163

In the Supreme Court of the United States

BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF COMMUNITY BANKERS ASSOCIATION OF ILLINOIS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

The Community Bankers Association of Illinois ("CBAI", or "Amicus Curiae CBAI") is a not-for-profit trade organization that was formed in 1974 to represent the interests of community banks. Community banks are state and federally chartered banks, typically with only one or very few (under five) branches, which primarily serve the interests of consumers and small businesses within a relatively small geographical area or community.

Illinois historically prohibited branch banking, and it was not until 1993 that all restrictions on branch banking were removed. Ill. Public Act 88-4 (1993) now codified at 205 ILCS 5/5(15). As a result, there are hundreds of community banks. Most are small banks, but all are vitally important to the communities they serve. They are not all, however, confined only to rural areas or small towns. Many community banks are located in metropolitan areas, including in the City of Chicago.

CBAI represents approximately 400 financial institutions in Illinois, which comprise approximately

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[1] Respondents have filed with this Court a blanket consent to *amicus* briefs. Petitioner has furnished a written consent to the filing of this brief, and a copy of that consent has been filed with this Court concurrently with the filing of this brief. No counsel for a party authored any part of this brief. No person, other than the Amicus Curiae CBAI or its counsel, has made a monetary contribution toward the preparation or submission of this brief. The law firm of SmithAmundsen LLC is an associate member of CBAI. The below signed Counsel of Record, as well as the individuals who are identified as Of Counsel, are partners in the firm of SmithAmundsen LLC.

70% of all bank and thrift charters in Illinois. CBAI also represents 150 associate members, consisting primarily of vendors that provide services to financial institutions, such as accountants, attorneys, and information technology providers. CBAI's statement of purpose declares, among other things, that "CBAI member banks and associate members share a common belief that community banks must survive, due to their role as primary lenders to consumers and small businesses that create more new jobs than other sector of our economy." Its mission statement accordingly provides, among other things: "The CBAI is dedicated to keeping community banks competitive for the benefit of their customers and communities they serve through delivery of quality education, effective political representation, and essential products and services."

CBAI's member banks, with clientele consisting mostly of consumers and small businesses, often lend money and take back junior mortgages on real estate to secure such loans. CBAI very conservatively estimates that there is at least $9.6 billion of outstanding debt secured by junior mortgages in Illinois,[2] and the actual

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[2] CBAI does not keep records of its members' collective aggregate second mortgage lending activity. Diligent research has found no published source estimating aggregate junior mortgage debt in Illinois. However, according to the U.S. Census Bureau, there were an estimated 15,773,702 housing units in the United States subject to some form of junior lien in 2013. United States Census Bureau, http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_13_1YR_B25081&prodType=table. Illinois has 4.072% of the population of the United States, United States Census Bureau, www.census.gov/popest/data/state/totals/2014/index.html, and CBAI estimates that Illinois should accordingly have about 4% of junior liens, which works out to

amount could be as high as $32 billion.[3] Nationally, the bulk of second liens are in the form of home equity lines of credit ("HELOCs") which take the form of revolving debt, and the balance is in the form of closed-end second liens ("CESs").[4]

CBAI is deeply concerned that a substantial portion of junior liens would be jeopardized by upholding the Eleventh Circuit Court of Appeals' decisions below that permit wholly underwater junior liens to be stripped-off or voided in bankruptcy. Nationwide, second liens represent an amount of money equaling more than one-half of all bank capital.[5] In addition, to the national impact, there would be significant and disproportionate impact upon community banks. Owing to their generally small size, community banks are least equipped to withstand the adverse impact of any lien being voided. Accordingly, for the foregoing practical reason and for the legal reasons argued below, Amicus

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642,305 units. Very conservatively estimating the average second mortgage to be $15,000.00, the resulting junior indebtedness in Illinois is $9,634,575,000.00.

[3] The Federal Reserve Bank estimated that, in 2012, aggregate national junior mortgage debt was in excess of $800 billion. *A New Look at Second Liens*, Federal Reserve Bank of New York, Staff Report 569 (Aug. 2012), at 1. Assuming Illinois' ratable share of that debt to be 4%, in accordance with its share of the national population, n.1, *supra*, the resulting amount of second mortgage debt in Illinois is about $32 billion.

[4] Ibid.

[5] *A New Look At Second Liens*, *supra*, n. 3, at 1.

Curiae CBAI joins Petitioner in respectfully urging reversal of the decisions below.

SUMMARY OF ARGUMENT

A. Factual Background

In each of these consolidated cases[6], Petitioner held a second lien on Respondents' respective residences. In each case, the court below voided ("stripped-off") Petitioner's junior lien based on a judicial determination that the lien had no monetary value at the time of the debtor's discharge in bankruptcy. The debtors, however, retained their respective properties to which the liens had previously been attached. Petitioner, accordingly, lost the opportunity to recover any of its indebtedness from possible future appreciation of the properties. Had Petitioner's liens been allowed to pass through bankruptcy unaffected, in accordance with century-old practice, Petitioner would have had a chance to recover something in the future, rather than being judicially sentenced to recover nothing. Petitioner was therefore deprived of a valuable right, even though, at a particular moment in time, its liens supposedly would have recovered no value from a liquidation sale.

B. Reasons To Reverse The Court Below

CBAI respectfully submits that for the following reasons, a lien cannot be stripped-off, and a creditor

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[6] *Bank of America, N.A. v. Caulkett*, Case No. 13-1421, hereinafter sometimes "*Caulkett*" and *Bank of America N.A., v. Edelmiro Toledo-Cardona*, Case No. 14-163, hereinafter sometimes "*Toledo-Cardona*"

cannot be denied future possible recovery merely because, at a single moment in time, that lien is judicially determined to have no recoverable value.

First, stripping-off liens is precluded by this Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992) ("*Dewsnup*"). As shown within, *Dewsnup* forbids stripping-down a lien, and its rationale equally precludes stripping-off a lien.

Second, stripping-off junior liens removes valuable property rights. That, in turn, implicates constitutional concerns. The Fifth Amendment to the Constitution of the United States provides, in relevant part, "No person shall be ... deprived of ... property without due process of law; nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V. Further, stripping-off valuable property rights violates Congressional policy to protect lienholders. Finally, even though liens may be stripped in Chapter 13 and Chapter 11 reorganization cases, it does *not* follow that they may be stripped in Chapter 7 liquidation cases for the reasons discussed *infra*.

Third, lienholders have a settled expectation, in reliance on this Court's prior cases, including *Dewsnup*, that liens will pass through bankruptcy unaffected. That expectation strongly militates against now permitting liens to be stripped-off.

Each of the above reasons, which are elaborated *infra*, is alone a sufficient reason to reverse the decision below of the Eleventh Circuit.

ARGUMENT

POINT I:
DEWSNUP PRECLUDES STRIPPING-OFF LIENS

The question posed in *Dewsnup* was, "[m]ay a debtor 'strip down' a creditor's lien on real property to the value of the collateral, as judicially determined, when the value is less than the amount of the claim secured by the lien?" *Dewsnup*, 502 U.S. at 411-412. At issue were conflicting interpretations of § 506(d), which provides, in relevant part: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void ..." 11 U.S.C. § 506(d).[7] The Petitioner in *Dewsnup* argued that under § 506(a), a claim is secured only to the extent of the (judicially determined) value of the lienholder's interest and is otherwise unsecured.[8] Petitioner then proceeded to infer that, to the extent the claim is unsecured under § 506(a), it is not an "allowed secured claim" under § 506(d). See *Dewsnup*, 502 U.S. at 414.

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[7] All references to sections or chapters are to those of the United States Bankruptcy Code, 11 U.S.C. § 101 *et seq.*

[8] 11 U.S.C. § 506(a)(1) provides, in part: "An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest ... and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim."

Respondent, on the other hand, argued that § 506(d) is not "rigidly tied" to § 506(a) because § 506(a) classifies claims for distribution purposes, while the avoidance provision of § 506(d) is "directed to the time at which foreclosure is to take place." *Id.*, 502 U.S. at 415.

This Court squarely resolved that conflict: "We hold that § 506(d) does *not* allow petitioner to 'strip down' respondents' lien ..." *Id.*, 502 U.S. at 417 (emphasis added). The Court relied heavily on the absence of express Congressional intent to abrogate the pre-Code rule that liens pass through bankruptcy unaffected.

> "...given the ambiguity in the text, we are not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected."

Dewsnup, 502 U.S. at 417.

Further, in finding it "not plausible" to think Congress had impliedly created a new remedy, this Court stated:

> " ... to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent that they become 'unsecured' for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles."

Dewsnup, 502 U.S. at 420.

The only factual difference between these instant cases and *Dewsnup* is that in *Dewsnup*, the Petitioner sought to reduce (strip-down) the value of the lien to an

amount less than the debt but greater than zero, whereas in these cases, the Eleventh Circuit stripped-off liens by reducing their value to zero. But that factual difference does not change the outcome, given the *ratio decidendi* in *Dewsnup*. It makes no sense to say that Congress created no implied remedy of stripping *down* a lien, but that the very same statutes do create an implied remedy of stripping *off* a lien. It is as if a rule forbidding wounding were understood to allow killing.

Indeed, every United States Circuit Court of Appeals which has considered the issue, except for the Court of Appeals for the Eleventh Circuit, has concluded that *Dewsnup* forbids stripping-off liens. *See*, *Ryan v. Homecomings Financial Network*, 253 F.3d 778, 782-783 (4th Cir. 2001) ("*Ryan*") (lien may not be stripped-off pursuant to provisions of §§ 506(a) and (d)); *In re Talbert*, 344 F.3d 555, 560-561 (6th Cir. 2003) (*Dewsnup* applies "with equal force and logic" and a Chapter 7 debtor may not strip-off a valueless junior lien), and *Palomar v. First American Bank*, 722 F.3d 992, 994 (7th Cir. 2013) (the only lien that can be voided by § 506(d) in whole or in part is a lien securing a claim rejected in whole or in part; statute has "no application" to a case where the junior lienholder has an allowed claim).[9]

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[9] Cases holding that *Dewsnup* forbids stripping-off liens exist at the sub-circuit level in a number of important jurisdictions. *See*, notably, *Laskin v. First National Bank of Keystone*, 222 B.R. 872 (9th Cir. BAP 1998). *See also*, *In re Swiatek*, 31 B.R. 26 (Bankr. D. Del. 1999) (*Dewsnup* reasoning applies whether a lien is partially or wholly unsecured); *In re Pistritto*, 2005 WL 906370 at *2 (Bankr. D. Del. 2005) ("courts in this Circuit generally conclude

Notably, in the decisions below, the court did not engage in an exegesis of *Dewsnup*, but instead relied on *McNeal v. GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012) (*"McNeal"*) (per curiam), which reaffirmed the Eleventh Circuit's pre-Dewsnup decision in *Folendore v. United States Small Business Administration*, 862 F.2d 1537 (11th Cir. 1989) (*"Folendore"*) to conclude that a wholly unsecured claim is voidable under § 506(d).[10] In *McNeal*, the court below held that, as a matter of its own internal jurisprudence regarding *stare decisis*, " ... a later panel may depart from an earlier panel's decision only when an intervening Supreme Court decision is 'clearly on point'." *McNeal*, 735 F.3d at 1265. The Eleventh Circuit went on to hold that *Dewsnup* was "not 'clearly on point'" because *Dewsnup* addressed "only" a strip down "and did not address a 'strip off'" *Id.* at 1265. Quoting one of its earlier cases, the Eleventh Circuit Court of Appeals then said:

> "[T]hat the reasoning of an intervening high court decision is at odds with that of our prior decision is no basis for a panel to depart from our prior decision."

Id., quoting *Atlantic Sounding Co., Inc. v. Townsend*, 496 F.3d 1282, 1284 (11th Cir. 2007). The decisions

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that a debtor may not strip off a lien in a Chapter 7 case under section 506(d)."); *In re Caliguri*, 431 B.R. 324 (Bankr. E.D.N.Y. 2010).

[10] The opinion below in *Caulkett* is unpublished, and is included as Appendix A the Certiorari Petition in *Caulkett*. The opinion below in *Toledo-Cardona* is unpublished, and is included as Appendix A to the Certiorari Petition in *Toledo-Cardona*.

below were thus predicated entirely on intra-circuit *stare decisis* rules, and not upon any analysis of how the reasoning of *Dewsnup* does or does not apply to stripping-off liens. Plainly, however, in light of *Dewsnup*, the decisions below should be reversed.

POINT II: JUNIOR LIENS ARE PROPERTY RIGHTS THAT REQUIRE PROTECTION

A. A Wholly Underwater Lien is a Valuable Property Right.

Amicus Curiae CBAI submits that a wholly underwater junior lien is still demonstrably a valuable property right. Property values fluctuate; a junior lien which is wholly underwater today may acquire value as the underlying property appreciates in the future. As the court noted in *Ryan*, "we are acutely aware that in the volatile, modern real estate market, substantial price variations do occur with weekly or monthly regularity." *Ryan*, *supra*, 253 F.3d at 783. The *Ryan* court's observation is empirically proven by the decline in negative homeowner equity that is accompanying the current economic recovery:

> "...the national negative equity rate continued to decline in Q2 2014, falling to 17 percent, down 14.4 percentage points from its peak (31.4 percent) in the first quarter of 2012." Negative equity has fallen for nine consecutive quarters as home values have risen."

Zillow Real Estate Research, www.zillow.com/research/2014-q2-negative-equity-report-7465/.

Given aggregate mortgage debt of over $13 trillion[11], the cited decline in negative equity represents perhaps as much as $1 trillion dollars of now recoverable value that was not available only two years ago. The cited decline in negative equity also means that about 7 million mortgages which were underwater barely over two years ago are no longer underwater today.[12] A substantial number of both first and second mortgages have gone from being undersecured to being fully secured, including presumably some second mortgages that formerly were wholly unsecured.

A lienholder's property right to take advantage of future increases in value of the property was recognized in *Dewsnup*,

> "Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors ... who had nothing to do with the mortgagor-mortgagee bargain."

Dewsnup, 502 U.S. at 417.

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[11] Aggregate national mortgage indebtedness is in excess of $13 trillion as of the third quarter of 2014. *See*, http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm.

[12] There were approximately 49.5 million residential properties with mortgages at the end of the second quarter of 2014. *See*, http://www.corelogic.com/about-us/news/corelogic-reports-946,000-residential-properties-regained-1-trillion-dollars-in-total-equity-in-q2-2014.aspx. Consequently, a 14.4 percentage point decline in the negative equity rate implies that over 7 million residential mortgages have gone from underwater to fully secured.

Because future appreciation may create realizable value, it is fundamentally fallacious to confuse a lien's liquidation value at a particular moment in time with the value of the *property right* which that lien represents. Amicus Curiae CBAI submits that because a lien's value transcends its momentary monetary liquidation value, a lien having a current judicially determined (that is to say, hypothetical) value of $0 is nevertheless entitled to protection.

B. Stripping-Off Liens Raises Constitutional Concerns.

Dewsnup was not expressly decided on constitutional grounds. Rather, as discussed above, this Court resolved the issue of statutory construction on the basis of preserving the pre-Code practice that liens pass through bankruptcy unaffected, citing both policy considerations and a lack of expressed Congressional intent to abrogate pre-Code practice. However, *Dewsnup* was decided in the context of a constitutional backdrop that liens are to be protected against judicial (i.e., government) takings. This Court's cognizance of that constitutional background is implicit in *Dewsnup's* mention, 502 U.S. at 419, of *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935) ("*Radford*") (per Brandeis, J.), discussed below. And while this Court can easily resolve the instant case in Petitioner's favor merely by applying the analysis in *Dewsnup*, Amicus Curiae CBAI submits that the constitutional significance of property rights in bankruptcy reinforces that strip-offs should not be allowed in Chapter 7 cases.

In *Radford*, this Court considered the constitutionality of portions of the Frazier-Lemke Act,

former 11 U.S.C. § 203(s). In particular, paragraph 7 of that Act provided, among other things, for a 5-year judicial stay of foreclosure proceedings with an option for the debtor to acquire full title and possession of mortgage property (as well as to obtain a bankruptcy discharge) by paying over the appraised value of the property. *See, Radford*, 295 U.S. at 575-576. Writing for a unanimous Court, Justice Brandeis bluntly recognized that the Frazier-Lemke Act's "avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' [i.e., strip-down the lien] to the present value of the property." *Radford*, 295 U.S. at 594. The Court then invalidated the Frazier-Lemke Act on constitutional grounds:

> "The province of the Court is limited to deciding whether the Frazier-Lemke Act ... as applied has taken from the bank without compensation, and given to Radford, rights in specific property which are of substantial value ... As we conclude that the act as applied has done so, we must hold it void; for the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for a wholly public use without just compensation."

Radford, 295 U.S. at 601-602.

Amicus Curiae CBAI recognizes that the reach of *Radford* may be somewhat uncertain. That case involved the passage of a statute after the creation of a lien, where the statute modified lienholder rights. No such intervening statute is present in these cases. Amicus Curiae CBAI also recognizes that cases subsequent to *Radford* seem to focus on protection of

lien *value* existing at the time of bankruptcy. *See*, *Wright v. Central Life Ins. Co.*, 311 U.S. 273, 278 (1940) (no constitutional right beyond protection of the value of the property).[13] *See also*, *United Savings Association of Texas v. Timbers of Inwood Forrest, Ltd.*, 484 U.S. 365, 377 (1988) (under § 1129(b)(2), "undersecured creditor's 'interest' is regarded (properly) as solely the value of the collateral").[14] And Amicus Curiae CBAI recognizes that this Court chose not to predicate its holding in *Dewsnup* directly upon *Radford's* constitutional analysis, although nothing in *Dewsnup* prevents or precludes so applying *Radford* then or to these cases.

That having been said, there is no dispute that a lien is a property right, and that its value is entitled to protection as a constitutional matter. *See*, *Wright*,

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[13] *Wright* involved a statutory construction issue whether a debtor's right to redeem could be defeated by a creditor's right to compel sale. 311 U.S. at 278. It was not necessary to the holding in *Wright* for the Court to say there was no constitutional right beyond protecting the value of the property; it would have been enough to have said that constitutional minima for an underwater first lien are satisfied by preservation of value. A statement beyond that is dictum, and should not be considered as an implied holding that wholly underwater liens have no right to constitutional protection. *See*, *Humphrey's Executor v. United States*, 295 U.S. 602, 626 (1935) ("*Humphrey's*") (expressions beyond the point involved do not come within the rule of *stare decisis*).

[14] *Timbers* involved whether an undersecured creditor is entitled to immediate foreclosure or accrual of post-petition interest on its claim. The referenced remark was a dictum, per *Humphrey's*, n. 13, *supra*, particularly since the word 'properly' was put in parentheses.

supra, 311 U.S. at 278. *See also*, *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935) ("*Murel*") (per Hand, J.) ("adequate protection" requirement of former 11 U.S.C. § 207(c)(10) must conform to constitutional limitations).[15] However, just because a junior lien has no realizable monetary value at a given moment in time does *not* entail that such a lien encompasses no rights and has no value worthy of protection. It is *not* inconsistent with the jurisprudence of this Court to date to say that the right to future appreciation in lien value is a right entitled to protection on constitutional grounds, and that such right may not be removed by judicial fiat.

At a minimum, the foregoing discussion illustrates a constitutional backdrop which reinforces why *Dewsnup* should be applied to forbid lien strip-offs and show the enormous stakes involved in protecting junior liens even if they are (momentarily) wholly underwater. Of course, nothing precludes this Court from reversing the court below on constitutional grounds.

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[15] Notably, Judge Hand's constitutionally-driven formula that adequate protection must afford the "indubitable equivalence" of the lien, *Murel*, 75 F.2d at 942, was legislatively incorporated twice into the Bankruptcy Code. Section 361 lists "indubitable equivalent" as among the means of providing adequate protection. And Section 1129(b)(2)(A)(iii) lists "indubitable equivalent" as among the required minimal treatment alternatives for a secured claim in a cram-down situation.

C. The Policy of the Bankruptcy Code is to Protect Liens.

Further, whatever the constitutional backdrop, drafters of the Code were explicit that they desired statutory protections for liens as a matter of policy:

> "It is not intended to be confined to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds."

H.R. Rep. No. 595 at 339, 1978 U.S. Code Cong. & Ad.News at 6295.

The legislative history goes on to state:

> "*Secured creditors should not be deprived of the benefit of their bargain*. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognized the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for."

Id. (emphasis added).

Most bluntly, the way to not deprive a wholly underwater junior lien of the benefit of the bargain is to let the lien pass through bankruptcy unaffected. Even if such passing-through is not constitutionally

required, it nevertheless would reflect the policy of the Code. Outcomes which harmonize with Congressional policy and interest are to be preferred. *See e.g., Air Line Pilots Association, International v. O'Neill*, 499 U.S. 65 (1991) (criticizing court below for failing to take into account strong public policy arguments). The decisions below should accordingly be reversed.

D. Lien Stripping in Chapter 13 and Chapter 11 Cases Does Not Support Lien Strip-Offs in Chapter 7 Cases.

Provisions in chapters of the Bankruptcy Code other than Chapter 7 that ostensibly permit lien stripping do not form compelling rationales to permit lien strip-offs in a Chapter 7 case. At the outset, lien stripping outside of Chapter 7 is not done under § 506(d), but is done under specific provisions of Chapters 13 and 11 which are not now before the Court and which were not before the Court in *Dewsnup*. At a statutory level, lien stripping not done under § 506(d) is simply inapposite to this case. Nevertheless, Chapter 13 and Chapter 11 provisions will now be addressed.

To the extent lien strip-offs are permitted in Chapter 13 cases,[16] the Court of Appeals for the Seventh Circuit has clearly explained why that would *not* justify lien strip-offs in a Chapter 7 case:

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[16] Chapter 13 prohibits lien stripping on mortgages which are the debtor's principle residences, 11 U.S.C. § 1322(b)(2), but ostensibly permits it for other liens. Notably, although § 1322(b)(2) does not, on its face, specifically permit the strip-off of a wholly underwater junior lien, many courts have concluded that such strip-offs are permissible. *See generally*, cases catalogued in *In re Davis*, 716 F.3d 331, 334-35 (4th Cir. 2013).

> "The strip-off right in a Chapter 13 is a partial offset to the advantages that Chapter 13, relative to Chapter 7, grants creditors, such as access to a larger pool of assets because the debtor must commit all disposable income for three to five years to repaying unsecured debts... The difference between Chapter 13 (also Chapter 11) and Chapter 7 is the difference between reorganization and liquidation."

Palomar v. First American Bank, supra, 722 F.3d 992, 995 (7th Cir. 2013) ("*Palomar*") (per Posner, J.)

Amicus Curiae CBAI notes that, in constitutional terms, Judge Posner's analysis suggests that Chapter 13 provides compensation (in the form of greater access to assets) for the taking of the lien. Chapter 7, of course, does not provide compensation, which is one reason why there are significant constitutional concerns with lien strip-offs in Chapter 7 cases even if strip-offs are permitted in Chapter 13 cases.

Nor are ostensible lien stripping provisions in Chapter 11 a true argument for permitting strip-offs in a Chapter 7 case. In the first place, *Palomar's* distinction, *supra*, between reorganization and liquidation is instructive. Chapter 11, like Chapter 13, is a reorganization which arguably affords at least some level of compensation for lien taking. Further, in a Chapter 11 case, a secured creditor may make the election provided by § 1111(b), which, in turn, entitles the lienholder to the treatment statutorily required by

§ 1129(b)(2).[17] Fundamentally, while this allows a lien to be stripped-down, it does not address stripping-off a lien.

It is true that there is no right to make the § 1111(b) election if the lien is of "inconsequential value." 11 U.S.C. § 1111(b)(1)(B)(i). Amicus Curiae CBAI submits, however, that the loss of the section 1111(b) election for liens of inconsequential value is *not* a warrant for lien strip-offs in Chapter 7 cases. Loss of the right to make the § 1111(b) election if the lien is of "inconsequential value" does not entail that voiding a wholly underwater lien is allowed. Loss of the election entails loss of the right for the *claim* to be treated under the Chapter 11 plan in accordance with the requirements of § 1129(b)(2). However, the loss of specific *claim* treatment is not the same as losing the lien. Indeed, since, under *Dewsnup* a lien with value cannot be stripped-down, and must pass through bankruptcy unaffected, the creditor's lien that has positive (but "inconsequential") value must pass through for the plan to comply with the requirement of § 1129(a)(7)(A)(ii) that the creditor receive at least which it would in a Chapter 7 liquidation case.[18] *See,*

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[17] If the property is sold, the creditor must be allowed to credit bid. 11 U.S.C. § 1129(b)(2)(A)(ii). If the property is retained by the debtor, the secured lender either gets the "indubitable equivalent", 11 U.S.C. § 1129(b)(2)(A)(iii), or must retain its lien and receive cash payments equaling the amount of the claim with a present value equal to the lien. 11 U.S.C. § 1129(b)(2)(A)(i).

[18] 11 U.S.C. § 1129(a)(7)(A)(ii) sets forth that among the requirements for confirmation of a Chapter 11 plan, that the holder of an impaired claim who has not accepted the plan "will receive or retain under the plan on account of such claim or

In re Stone & Webster, Inc., 286 B.R. 532, 545 (Bankr. D. Del. 2002) (best interest of creditors test of § 1129(a)(7) is a "guaranty" to each claim holder that it will receive at least as much in reorganization as it would receive in a liquidation).

Nor can it be argued that wholly underwater junior liens can be stripped-off in Chapter 11. That argument begs the question now before the Court: whether such liens can be stripped-off in Chapter 7. Only when that issue is resolved can it be known if the best interest of creditors test of § 1129(a)(7) permits such liens to be stripped-off under a Chapter 11 plan.

In sum, lien stripping provisions in Chapters 13 and 11 do not provide a warrant for stripping-off liens in Chapter 7 cases. Accordingly, the decisions below should be reversed.

POINT III:
ALLOWING A LIEN TO BE STRIPPED-OFF BASED ON A JUDICIAL DETERMINATION OF VALUE RISKS UNJUSTLY VOIDING LIENS THAT IN REALITY ARE NOT WHOLLY UNDERWATER

Dewsnup clearly forbids stripping-down a lien if that lien has one cent or more of realizable value. Such a lien may pass through bankruptcy unaffected, and the lienholder may benefit from future appreciation. The consequence of Respondent's position, however, is

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interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under Chapter 7 of this title on such a date..."

that if the same lien is wholly underwater by one cent, it can be voided. Thus, a one cent difference in a judicially determined valuation would make the difference between preservation of a right and its complete and permanent loss.

Unfortunately, in the real world, judicial determinations of value are not inerrant. Such determination rest on appraisals.

> "But errors in appraising a house are common because 'real estate appraisal is not an exact science ... common enough to have created a market for 'Real Estate Appraisers Errors & Omissions insurance policies."

Swanson v. Citibank, N.A., 614 F.3d 400, 408 (7th Cir. 2010) ("*Swanson*") (Posner, J., dissenting in part)(internal citation omitted).

Indeed, an appraisal, by definition, is an opinion of value. *See, The Appraisal of Real Estate*, 14 ed., p 2 (Appraisal Institute, 2013). Frequently, different methods are employed which lead to disparate results, which then must be reconciled, leading to a final opinion expressed across a range of value. *Id., 641-646. Cf, Silverman v. Commissioner of Internal Revenue*, 538 F.2d 927, 933 (2d Cir. 1976) (valuation is necessarily an approximation); *In re R & H Investment Co., Inc.*, 46 B.R. 114, 116 (Bankr. D. Conn. 1985) (court can only make 'reasonable estimate' of value); *In re Jug End in the Berkshires, Inc.*, 46 B.R. 892, 900 (Bankr. D. Mass. 1985) (no property value determined by appraisal rests on scientific analysis). And opinions, no matter how informed and educated, can err. Placing the survival of a right on a process in which errors are

too common is simply antithetical to that right. The rule urged by Respondent will inevitably result in some junior liens being voided, even though they are not wholly underwater, merely because someone estimates they are wholly underwater.

In a closely related context, even the Eleventh Circuit Court of Appeals recognized the perils of relying on the inherently inexact appraisal process. In *In re Dickerson*, 222 F.3d 924 (11th Cir. 2000), the court convincingly criticized its own precedent even while permitting lien stripping in a Chapter 13 context.[19] It stated:

> "However, were we to decide this issue on a clean slate, we would not so hold. We find persuasive the district court's reasoning that providing 'anti-modification' protection to junior mortgagees where the value of the mortgaged property exceeds the senior mortgagee's claim by at least one cent, as prescribed by the Supreme Court's decision in *Nobleman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993), but denying that same protection to junior mortgagees who lack that penny of equity, places too much weight upon the valuation process. As we have noted, '[v]aluation outside the actual market place is inherently inexact." *Rushton v. Commissioner of Internal Revenue*, 498 F.2d 88, 95 (5th Cir. 1974). *Given the unavoidable imprecision and*

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[19] *See infra.*, beginning at p. 17 for a discussion of why lien stripping in Chapter 13 is *not* a basis for allowing strip-offs in Chapter 7 cases such as the instant ones now before the Court.

> *uncertainty of the valuation process, we think that choosing to draw a bright line at this point is akin to attempting to draw a bright line in the fog."*

Id. at 926. (emphasis added).

Nor is simple error in estimating value the only, or even the largest, risk. Cases frequently occur in which a court is asked to resolve extremely differing appraisals. *See, e.g., CSX Transportation, Inc. v. Georgia State Board of Equalization*, 552 U.S. 9, 14 (2007) ($4.6 million vs. $7.8 million for real property); *In re Morysville Body Works, Inc.*, 86 B.R. 51, 52 (Bankr. E.D. Pa. 1988) ($375,000.00 vs. $934,000.00); *Swanson, supra*, 614 F.3d at 403 ($170,000.00 v. $240,000.00). The difficulty with situations where disparate appraisals are presented is that genuine accuracy is often impossible. In *In re Rogers Development Corp.*, 2 B.R. 679, 684-85 (Bankr. E.D. Va. 1980) ("*Rogers Development*"), the court was faced with disparate appraisals of $801,000.00 and $704,000.00 and concluded that the difference was properly attributable to a difference of professional opinion. Perhaps predictably, the Court split the difference and found the property to be worth $750,000.00. *Id.* Consider, however, a *Rogers Development* situation in the world Respondent would create. Assume there is a $150,000.00 first mortgage and a $50,000.00 junior mortgage. Further assume that conflicting appraisals for the property come in at $185,000.00 and $215,000.00. What is the fate of the second lien?

It is particularly troubling that a second lien could be lost when it is only dubiously wholly underwater. Admittedly, the courts do resolve valuation issues

routinely, but this does not mean judicial determinations of value are an optimal means of determining value. An appraisal is a technique for estimating value when an actual sale cannot take place, as in a condemnation proceeding, or, as with many "fairness opinions," an actual sale takes place under non-competitive conditions necessitating some estimate of how the asset would fare in fully competitive setting.

Where appraisals can be avoided in deference to the market, they should be avoided. Bankruptcy presents many circumstances where reliance on appraisals is avoided by recourse to the market. In at least two bankruptcy circumstances, this Court has deferred to the market to determine value rather than rely on appraisals. First, in *Bank of America National Trust and Savings Association v. 203 North LaSalle St. Partnership*, 526 U.S. 434 (1999), ("*203 N. LaSalle*"), this Court held that a debtor's equity owners may give subsequent new value to retain equity (assuming *arguendo* an exception to the absolute priority rule) only if the equity interest is exposed to competing bids in the market, or others are given the opportunity to propose a competing plan. *See*, 526 U.S. at 454 and 458. This Court declined to allow equity to be retained based on merely a judicial determination (appraisal) of the value of equity.

Second, in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065 (2012)("*RadLAX*"), this Court re-affirmed as inviolate the right to credit bid in sale held under Chapter 11 plans. *RadLAX* assures that the lien holder cannot be deprived of the value of its lien by a judicial determination of that

value, but rather only by the lienholder's own assessment of the property's value and voluntary decision not to credit bid. Nothing in *RadLAX* limits it to senior mortgages or precludes its application to wholly underwater liens. An underwater junior lien should be able at a foreclosure sale to pay off the senior lien and credit bid some or all of the junior debt. That outcome, of course, reflects the basic bargain between the mortgagor and mortgagee, and also puts the lienholder in charge of what investment to make to protect its interest in property, which is the antithesis of a government (judicial) decision whether to take away that interest without compensation.

In short, an important implication of cases such as *RadLAX* and *203 N. LaSalle* is that judicial determinations of value are disfavored to limit rights (or eliminate rights, as Respondent would do in this case) where a market-based alternative is available. In this case, such an alternative is available: let the lien pass through bankruptcy unaffected as has been the rule for well over a century. The decisions below should be reversed.

POINT IV:
LENDERS HAVE A SETTLED EXPECTATION THAT LIENS WILL PASS THROUGH BANKRUPTCY UNAFFECTED

The principle that liens pass through bankruptcy unaffected was recognized in, but clearly predates, *Long v. Bullard*, 117 U.S. 617, 620-21 (1886). It has thus been highly settled law for more than 125 years that liens pass through bankruptcy unaffected. *See also, Dewsnup*, 502 U.S. at 418, citing *Farrey v. Sanderfoot*, 500 U.S. 291, 297 (1991). *Cf., Palomar,*

supra, 722 F.3d at 993, describing the principle that liens pass through bankruptcy unaffected as a "venerable principle." The ability to ride-out downward fluctuations in value is vital to mitigating creditor risk, and is thus a factor that affects, in the first instance, the decision whether to extend credit *at all*, and in the second instance, what interest rate to charge.

There can be no doubt that lenders rely on the "venerable principle" that liens pass through bankruptcy unaffected. Indeed, not only case law but legislative history buttresses such reliance. Strikingly, the House Committee Report on the Bankruptcy Code stated point-blank: "[s]ubsection (d) permits liens to pass through bankruptcy unaffected." HR Rep. No. 95-595 at 357 (1978). Failure to reverse the decisions below will jeopardize a significant portion of hundreds of billions of dollars in junior mortgage debt that has been extended, at least in part, on reliance that liens pass through bankruptcy unaffected.

It seems inconceivable that any mortgage lender ever thought it would lose permanently its *legal* right to a lien because vicissitudes in the real estate market temporarily deprived a junior lien of recoverable value. Instead, lienholders understand that a lien reflects the basic combining of *in personam* and *in rem* relief, which is a hallmark of bankruptcy, and which was recognized in a different context by this Court and expressed as follows: "Rather a bankruptcy discharge extinguishes only one mode of enforcing a claim – namely, an action against the debtor *in personam* – while leaving intact another – namely, an action against the debtor *in rem*." *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991).

Pending the filing of Respondent's brief, it remains to be seen if Respondent will explicitly request that *Dewsnup* be overruled. But there should be no mistake: at least implicitly, the Respondent would overrule *Dewsnup* in the case of a wholly underwater lien. Thus, whether as an explicit or implicit matter, this case implicates the *stare decisis* treatment of *Dewsnup*. As this Court has stated:

> "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved."

Payne v. Tennessee, 501 U.S. 808, 828 (1991), and see the numerous cases therein cited.[20] *See also*, *Minnesota Co. v. National Co.*, 70 U.S. 332, 334 (1865):

> "...where courts vacillate and overrule their own decisions on the construction of statutes affecting the title to real property, their decisions are retrospective and may affect titles purchased on the faith of their stability. Doubtful questions on subjects of this nature, when once decided, should be considered no longer d[illegible]ibtful or subject to change."

Lien rights are property rights, and stripping-off a lien is every bit as severe as compromising title to real property. Hundreds of billions of dollars in credit

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[20] *Payne* was a criminal sentencing matter which chose to overrule a precedent involving, as the Court put it, mere "procedural and evidentiary rules." 501 U.S. at 828. However, the holding in *Payne* does nothing to negate the proposition for which it is cited above.

secured by junior liens has been extended by lenders believing that liens pass through bankruptcy unaffected, whether or not the junior lien is temporarily either partially or wholly underwater. That a lien passes through bankruptcy unaffected is a longstanding "rule of property" which stands at the "acme" of considerations of *stare decisis*. One thing is certain: the decisions below weakly distinguish the instant cases from *Dewsnup*, but express absolutely no basis for overruling *Dewsnup*. And reliance interests strongly mitigate against overruling *Dewsnup*.

Lastly, this Court has also stated that "considerations of stare decisis weigh heavily in the area of statutory construction where Congress is free to change this Court's interpretation of its legislation." *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977). Certainly, this reinforces the need to stand by *Dewsnup* insofar as *Dewsnup* was explicitly decided on statutory construction grounds.

It is clear that case law and legislative history provide that liens pass through bankruptcy unaffected. This court has been firm that a "clear, well established" and "basic" bankruptcy practice should not be eroded absent a "clear indication of Congressional intent. *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998). The Court has also said that state law property rights are not to be abrogated unless it is "clear and manifest" that Congress so intended. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 543-45 (1994).

Accordingly, when reliance interests, *stare decisis* considerations, Congressional intent, and rights under state law are combined, it is manifest that the decisions below should be reversed.

CONCLUSION

For each and every of the foregoing reasons, the decision of the Eleventh Circuit Court of Appeals should be reversed in both of these cases.

Respectfully submitted,

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